13-1753

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BARBARA KEILER, on behalf of themselves and all others similarly situated MONA GAY THOMAS, on behalf of themselves and all others similarly situated and LINDA BARRETT,

Plaintiffs-Appellants,

v.

HARLEQUIN ENTERPRISES LIMITED, a Canadian corporation, HARLEQUIN BOOKS S.A., a Swiss company, and HARLEQUIN ENTERPRISES B.V., a Dutch company,

Defendants-Appellees.

On Appeal from an Order Granting Defendants' Motion to Dismiss Plaintiffs' First Amended Complaint, Entered on April 2, 2013, by the United States District Court for the Southern District of New York, No. 1:12-cv-05558-HB, Before the Honorable Harold Baer, Jr.

BRIEF OF *AMICI CURIAE*
ROMANCE WRITERS OF AMERICA AND THE AUTHORS GUILD
IN SUPPORT OF APPELLANTS AND REVERSAL

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CORPORATE DISCLOSURE STATEMENT

Pursuant to F.R.A.P. 26.1, *Amici Curiae* make the following disclosure: Romance Writers of America, Incorporated is a nonprofit association without shareholders. The Authors Guild, Inc. and its forerunner, the Authors League of America, are nonprofit professional societies without shareholders.

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STATEMENT OF CONSENT TO FILING

Undersigned counsel for the *Amici* have requested the parties' consent to file an *Amicus* Brief. Plaintiffs-Appellants have consented. Defendants-Appellees have declined to consent. The *Amici* are filing herewith a Motion for Leave to File *Amicus* Brief.

IDENTITIES AND INTERESTS OF THE *AMICI* [1]

Romance Writers of America, Incorporated ("RWA") is a nonprofit association dedicated to advancing the professional interests of career-focused romance writers through networking, education, and advocacy. Founded in 1980, RWA has over 10,000 members and 145 chapters in the United States and Canada. Based on the core principle that romance writers have the right to reasonable remuneration and preservation of authorial and intellectual property rights, RWA works to support its members in building careers and earning their livings. RWA serves as the collective voice of romance writers and prides itself on working collaboratively and constructively with book publishers while advancing the interests of romance writers.

The Authors Guild, Inc. ("The Authors Guild") is the nation's oldest and largest professional society of published authors, representing more than 8,500 published book authors. The Authors Guild and its forerunner, the Authors League of America, have promoted the rights and business interests of authors – including the authors' vital interests in effective copyright protection, fair publishing

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[1] No party's counsel authored this brief in whole or in part. No party or party's counsel made any monetary contribution intended to fund the preparation or submission of this brief, and no person other than *Amici* or their counsel made such a monetary contribution.

contracts, and free expression – since 1912. The Authors Guild attorneys review hundreds of publishing contracts for members every year.

Undersigned counsel for the *Amici* have requested the parties' consent to file an *Amicus* Brief. Plaintiffs-Appellants have consented. Defendants-Appellees have declined to consent. The *Amici* are filing herewith a Motion for Leave to File *Amicus* Brief.

SUMMARY OF THE ARGUMENT

In order to avoid undue repetition, this brief does not repeat to any material degree the facts recited or arguments made in the Opening Brief of Plaintiffs-Appellants.

In the experience of the *Amici*, the Harlequin publishing contracts involved in this case contained customary royalty rate provisions at the time the contracts were executed. Specifically, the 50% royalty payable to the authors under the "all other rights" provision was a customary royalty for sales in secondary media such as electronic books, which had yet to establish a substantial market. In practice, however, Harlequin's inter-affiliate licensing and royalty arrangement for electronic books is depriving the authors of the benefit of this provision.

When the subject contracts were executed during 1990 to 2004, no one could have anticipated the explosive growth in the electronic book industry that occurred

during 2008 to 2012. Harlequin is now digitizing large numbers of its older books that are no longer in print, but which are still subject to the publishing contracts executed from 1990 to 2004. The *Amici* believe that Harlequin is attempting to maximize its profits from re-publishing these older titles in the new electronic medium, by using an inter-affiliate licensing and royalty arrangement to minimize the royalties it pays to its Swiss "Publisher" affiliate and the resulting e-book royalties paid to authors.

As explained in Plaintiffs-Appellants' Opening Brief, the publishing contracts at issue in this case require that any licensing arrangement between Harlequin affiliates must provide to the "Publisher" under the contracts (the Swiss subsidiary of Harlequin Enterprises) license proceeds that are "equivalent to the amount reasonably obtainable by Publisher from an Unrelated Licensee for the license or sale of the said rights." In the experience of the *Amici*, the royalty that Harlequin Enterprises pays to its Swiss "Publisher" subsidiary of 6% to 8% of the cover price of each e-book sold is a small fraction of the licensing proceeds that the "Publisher" could obtain from an unaffiliated licensee in the open market. Given Harlequin's dominance in the romance novel genre, Harlequin's Swiss "Publisher" subsidiary could command license fees of 50% to 70% of the cover price if its

parent corporation, Harlequin Enterprises, would allow it to operate as a normal publisher in the marketplace.

From the perspective of the *Amici*, Harlequin's inter-affiliate licensing and royalty arrangement is an unprecedented artifice designed to deprive the authors the benefit of the "all other rights" royalty provision in Harlequin's 1990 to 2004 publishing contracts. The *Amici* respectfully submit that Plaintiffs-Appellants have identified a true injustice and should be permitted to have their day in court.

ARGUMENT

In a traditional book publishing contract, an author licenses to a publisher all or part of the rights protected by copyright in a particular work. The publisher undertakes to print and market the book for sale, and the publisher agrees to pay the author a royalty rate that is a percentage of the proceeds the publisher receives from sales of the work. Traditionally, an author or his or her agent contracts directly with a publisher without the involvement of an intermediate entity.

For printed books (*i.e.* printed on paper), royalties paid to authors have traditionally gravitated to a range of 8% to 15% of proceeds from the publisher's exercise of "primary" rights such as the sale of printed books, and a minimum of 50% of proceeds from the publisher's exercise of "subsidiary" rights such as licensing an audiotape or foreign translation of the book. The rationale for the

different royalty rates is that the publisher does the "heavy lifting" in editing, manufacturing, distributing, promoting and funding the print publication and therefore deserves a higher return from its exercise of print rights; in contrast, proceeds from later sales and licenses for other media where the "heavy lifting" has already been done and the publisher has been compensated accordingly, justifies a more even split between publisher and author.

Harlequin is the dominant publisher in the romance novel genre. The publishing contracts at issue in this case were executed between 1990 and 2004, and apply to novels initially published in print during that period. These contracts follow the traditional royalty structure described above. As explained in Appellants' Opening Brief, this case involves a 50% author royalty percentage under the "all other rights" clause in Harlequin's standard publishing contracts executed during 1990 to 2004. This royalty rate reflects a customary split of the proceeds that might be received in secondary media after Harlequin performed the "heavy lifting" of successfully publishing the print version of a book.

When the subject contracts were executed, few people could have anticipated the meteoric rise in e-book sales that occurred beginning in 2008. From 2008 to 2012, e-book sales grew from $64 million annually to over $3.0 billion annually – an increase of over 4,700%. To a significant extent, these

increasing e-book sales have come at the expense of decreasing print book sales. Bottom line profitability for publishers has generally increased, however, because e-books can be substantially more profitable than print books due to the reduced costs of reproduction, warehousing, and distribution.

The e-book transformation in the publishing industry holds enormous potential for Harlequin. Harlequin has recently been engaged in a massive program of digitizing its "backlist" -- books that are no longer in print but are still under its control pursuant to the original publishing contracts. According to the 2011 Annual Report of Harlequin's parent company:

> . . . Harlequin's management team continued to adapt very successfully to the shift to digital reading, with total revenue reaching $459 million. . . . Harlequin continues to evolve its business successfully, focusing on providing great reading entertainment to women around the world in an increasingly digital environment. In 2011, Harlequin . . . digitized more than 5,200 new and older titles. In 2011, Harlequin.com received an average of approximately 6.5 million page views a month and an average of about 301,000 unique visitors a month . . . . An additional 1.3 million page views a month were received on Harlequin's digital book store . . . .
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> * * *
>
> . . . Harlequin has been digitizing its backlist for a number of years and now has more than 14,000 digital titles available for sale . . . .

(*Torstar Corporation 2001 Annual Report*, pp. 4, 38.)

In the spring of 2011, *Amicus* The Authors Guild began receiving reports from its members that their e-book royalties from Harlequin were extremely low. These members believed Harlequin was self-dealing by licensing e-book rights to one of its corporate affiliates for 6% of the cover price (*i.e.* suggested retail price). Because the royalty payable to the author under the "all other rights" clause is 50% of the amount received by the publisher, a 6% royalty to the publisher results in a royalty to the author of only 3% of the cover price – far below the customary range for sales in secondary media. The Authors Guild contacted Harlequin to voice these concerns and to request a copy of Harlequin's inter-affiliate license agreement. Harlequin declined to provide the document on the ground that it was proprietary.

During the same timeframe, *Amicus* RWA was also in communication with Harlequin regarding e-book royalty issues. Harlequin provided to its authors, RWA, and other industry participants the following explanation of Harlequin's inter-affiliate licensing practice:

> Our authors contract with Harlequin Books SA ("HBSA"), our related Swiss company. HBSA licenses the right to publish an author's work in print and digital to our operating companies and to third party publishers, which then bring books to market in their country (incurring costs of translation, production, distribution, marketing, branding, etc.). In return, HBSA receives a license fee. The NAR [net amount received by the Publisher] is the license fee. For editions where the author is to be paid 50% of NAR, the author's

> royalty is therefore 50% of the license fee received by HBSA. The license fees are expressed as a percentage of cover price. Historically they ranged from 6% to 8%. The author's 50% share of that fee would then equal 3% to 4% of the cover price.

(August 10, 2011, "*Q&A document 2011 – Changing Harlequin's Series and Single Title Digital Royalty Rates for English Language Editions in the United States and Canada.*")

As noted, the publishing contracts at issue require that in any affiliate licensing arrangement the "Publisher" must receive license proceeds that are "equivalent to the amount reasonably obtainable by Publisher from an Unrelated Licensee for the license or sale of the said rights." Based on their considerable reservoirs of knowledge and industry data sources regarding royalty rates in the publishing industry, the *Amici* confidently represent to this Court that the 6% to 8% royalty that Harlequin Enterprises elects to pay to its Swiss "Publisher" subsidiary is a small fraction of the proceeds that the "Publisher" could obtain from an unaffiliated licensee in the open market for e-books.

Generally speaking, a book publisher makes money by exercising the rights that it has licensed from the author of a given work, through the sales of books or sub-licenses of publication rights in various sales and distribution channels. Historically, the primary sales channel for print book publishers was through retail book stores. In the modern era of e-books, publishers sub-license their digital

copyright rights to online "e-tailers." The most well-known e-tailers of e-books are Amazon, Barnes & Noble, and Apple, but there are many others in the field.

There is no hard and fast rule or convention in the publishing industry on the royalty rates or license fees paid by e-tailers to publishers for e-books. There are, however, numerous sources of data on the market's behavior. In the experience and collective knowledge of the *Amici*, publishers are almost universally able to extract from an e-tailer at least 50% of the cover price of an e-book. A 70% split for the publisher is quite common and can be obtained even from industry power-houses such as Amazon and Apple.

It is clear to the *Amici* that if the Harlequin's Swiss "Publisher" subsidiary operated as a normal market participant, it could readily license the new e-book versions of its backlist for license fees of 50% to 70% of the cover price of each work sold. In this scenario, the 50% royalty payable to authors under the 1990 to 2004 publishing agreements would be 25% to 35% of the cover price of each work sold. Instead, however, the Swiss "Publisher" licenses the e-books to its parent, Harlequin Enterprises, for 6% to 8% of the cover price, and the authors' 50% royalty is thus only 3% to 4% of the cover price. From the perspective of the *Amici*, it appears that Harlequin Enterprises has simply siphoned off 42% to 64%

of the cover price before the money reaches the Swiss "Publisher" subsidiary, so this amount will not have to be split with the authors.

The following table illustrates the effect of Harlequin's affiliate licensing structure by comparing a customary market royalty scenario with the Harlequin scenario. Both scenarios assume a cover price of $7.99 and a royalty paid by the e-tailer to the publisher of 70% of the cover price; the Harlequin scenario further assumes a royalty paid by Harlequin Enterprises to its Swiss "Publisher" subsidiary of 8% of cover the price.

Market-Rate E-Book Royalties		**Harlequin E-Book Royalties**	
Retail Price	$7.99	$7.99	Retail Price
E-tailer Share (30% of retail)	$2.40	$2.40	E-tailer Share (30% of retail)
Publisher's Proceeds	$5.59	$5.59	Harlequin Enterprises Proceeds
Author's 50% of Publisher's Proceeds	**$2.80**	$0.64	Swiss "Publisher's" Proceeds (8% of cover price)
		$0.32	**Author's 50% of "Publisher's" Proceeds**

Other examples with different assumptions could be given, but it is clear that under any plausible scenario Harlequin's affiliate licensing structure diminishes the royalty paid to the author by an order of magnitude.

In sum, the paltry licensing fee that Harlequin Enterprises pays to its Swiss "Publisher" subsidiary is a small fraction of what a publisher can readily obtain from unaffiliated licensees in the vibrant e-book marketplace. Harlequin's machinations are unprecedented in the publishing industry, contrary to the reasonable expectations of the authors, and an abuse of the pricing discretion that the publishing contracts confer upon Harlequin.

The *Amici* are mindful that the 1990 to 2004 publishing contracts at issue here expressly authorize Harlequin to utilize an affiliated entity publishing and royalty structure. The *Amici* believe, however, that in exercising this prerogative Harlequin is constrained by an obligation of good faith and by the express contractual requirement that the royalties paid to the Swiss "Publisher" subsidiary will be "equivalent to the amount reasonably obtainable by Publisher from an Unrelated Licensee for the license or sale of the said rights." It is apparent to the *Amici* that Harlequin has not honored either constraint.

The *Amici* submit that, at a minimum, the Plaintiff's-Appellants have stated a viable cause of action, and that the District Court's Order dismissing the lawsuit on the face of the Complaint should be reversed.

CONCLUSION

WHEREFORE, *Amici Curiae* Romance Writers of America and The Authors Guild respectfully request this court to reverse the judgment of the District Court and remand the case for further proceedings on the merits.

Submitted this 30th day of September, 2013.

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 2,471 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P.32 (a)(6) because this brief has been prepared in a proportionately space typeface using Microsoft Word 2003 in Times New Roman 14-point font.

Dated this 30th day of September, 2013.

/s/ F. Brittin Clayton III

CERTIFICATE OF SERVICE & CM/ECF FILING

I hereby certify that on this 30th day of September, 2013, I caused a pdf version of the foregoing brief to be filed electronically using the CM/ECF system. Prior to transmittal, the pdf was scanned for viruses and no viruses were detected.

/s/ F. Brittin Clayton III